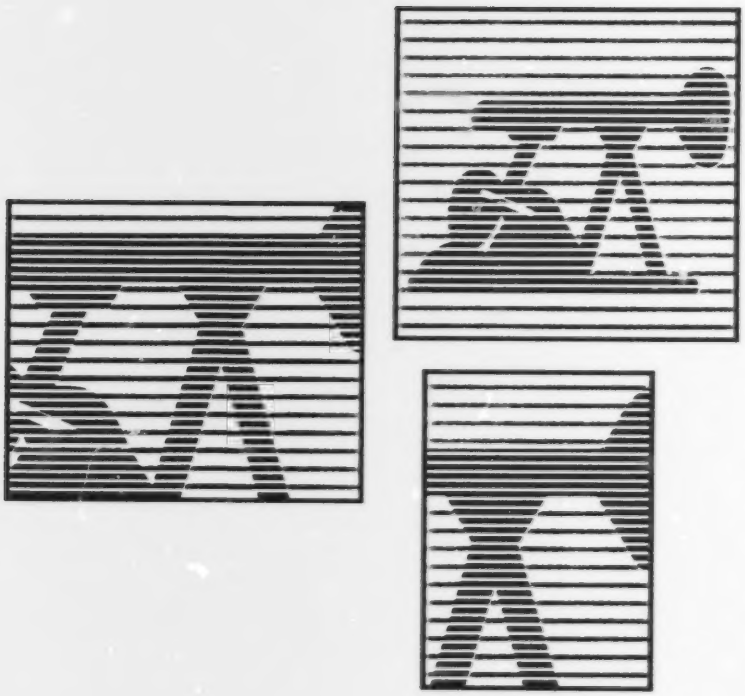
MANITOBA OIL AND GAS CORPORATION

ANNUAL REPORT 1987



CORPORATE PROFILE

Manitoba Oil and Gas is a 100 percent Manitoba-owned Crown corporation established in 1983 by the Provincial Government. It was created to operate, without special privilege, in the petroleum industry.

Its objectives are to achieve corporate profitability and to promote the development of Manitoba's petroleum resources through direct participation in oil and gas exploration and development.

LETTER OF TRANSMITTAL

The Honourable George Johnson
Lieutenant Governor of the Province of Manitoba

May it please your Honour:
I have the honour of presenting to you the Annual Report of The Manitoba Oil and Gas Corporation for the year ended December 31, 1987.

Jerry Storie

Jerry Storie
Minister Responsible for
The Manitoba Oil and Gas Corporation

HIGHLIGHTS

Financial	1987	1986	1985	1984
Revenues	**$ 1,203,048**	$ 628,581	$ 422,468	$ 5,800
Cash flow (deficiency) from operations	**230,591**	(84,497)	(16,574)	(325,324)
Net loss	**244,536**	370,455	134,528	495,384
Capital expenditures	**3,370,404**	3,662,655	2,653,182	792,150
Total assets	**14,679,330**	9,479,388	4,772,435	4,646,119
Shareholder's equity	**13,755,097**	8,999,633	4,370,088	4,504,616

Operating				
Production — Barrels per day	**212**	110	55	—
Wells participated in:				
Gross	**20**	28	13	3
Net	**11.9**	16	6.2	0.65
Land Holdings — acres:				
Gross	**47,207**	37,387	19,529	1,280
Net	**38,998**	32,898	13,436	532
Proved reserves before royalties (barrels)	**1,319,000**	1,081,000	375,600	—

Metric Conversion Factors

1 cubic metre = 6.29 barrels petroleum liquid (oil)
1 hectare = 2.47 acres
1 kilometer = 0.62 miles

CHAIRMAN'S MESSAGE

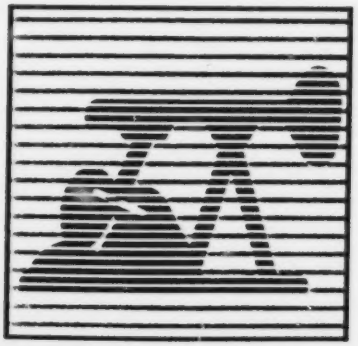
During the past year the Corporation continued to contribute to the development of Manitoba's petroleum resources while at the same time providing much needed activity in the service sector of the industry. Manitoba Oil and Gas participated in approximately 20 percent of the wells drilled in the province. The Corporation's average working interest in these drilling programs was 60 percent with partners providing the remaining investment funds.

While prices rebounded somewhat during 1987, downward pressure on price was again evident at year end. Despite this, the Corporation is now in a position of contributing positive cash flow and making steady progress toward achieving a profitable operation.

As part of the Provincial government's policy initiatives in the natural gas sector, Manitoba Oil and Gas Corporation was directed to act as a purchasing agent, on behalf of Manitoba consumers, in obtaining competitively-priced long term supplies of natural gas. The Corporation's application to the National Energy Board to order TransCanada Pipelines Limited to transport the gas was denied in September 1987. Leave for appeal of this decision to the Federal Court of Canada has been requested.

The Board appreciates the efforts of the employees in the achievements recorded to date in this report.

Robert M. Silver
Chairman



PRESIDENT'S MESSAGE

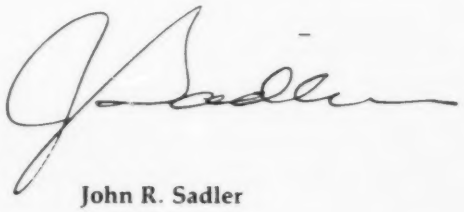
1987 has been an encouraging year for the Corporation. Revenues have doubled over 1986, reflecting an improvement in crude oil prices and a 90 percent increase in production.

Since its inception in 1984, the Corporation has acquired a 'hands-on' understanding of Manitoba's resource potential and is demonstrating the opportunities available to the industry in this part of the Williston Basin. The Corporation participated in 6 of the 33 exploratory tests drilled in the province for a success rate of 60 percent. It is through exploration activities such as geophysical studies and exploratory tests that extensions to existing fields or new fields will be found. Overall, MOGC participated in 20 wells with a 75 percent success rate and 60 percent average working interest.

At the same time as achieving these growth levels, operating costs and administrative costs have been contained, enabling most of the margin to flow to the bottom line. This will become even more evident as the Company continues to mature. At year end, over 50 percent of net sales were from Company-operated wells. Our Virden office, established in the fall of 1986, was a key component in this achievement.

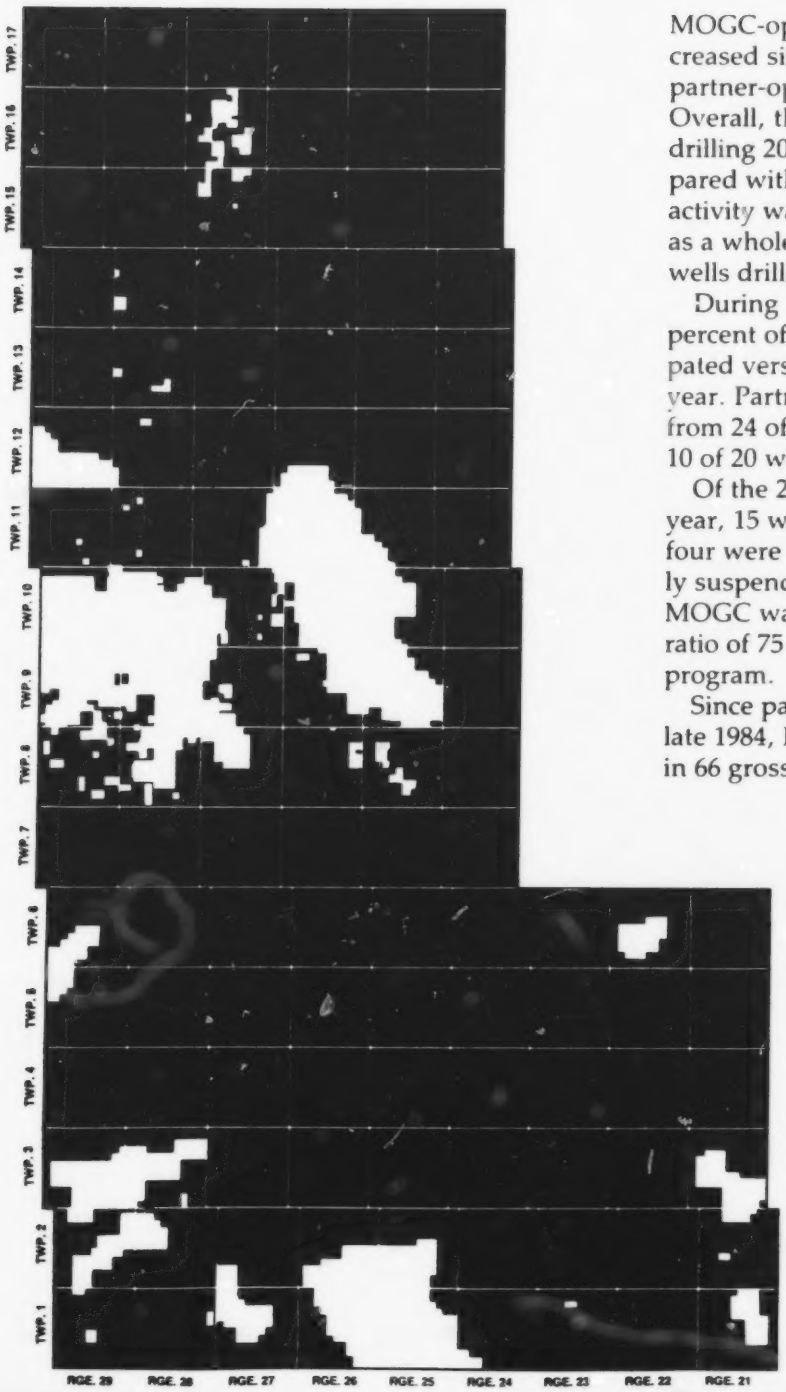
The outlook for crude oil prices is uncertain but the Corporation is confident it can continue to find, develop and produce oil economically at $20 (Cdn.) per barrel.

During 1987 the Corporation was asked by the Provincial government to determine the availability and price of natural gas in the newly deregulated gas market and, subsequently, undertook these and other related activities at the direction of the government. The Company's role in future natural gas activities is uncertain at this time and is awaiting further government direction.



John R. Sadler
President

EXPLORATION AND DEVELOPMENT



MOGC-operated drilling activity increased significantly during 1987 while partner-operated drilling decreased. Overall, the Company participated in drilling 20 wells during the year, compared with 28 in 1986. This decline in activity was reflected within Manitoba as a whole, which saw a drop from 135 wells drilled in 1986 to 107 in 1987.

During 1987, MOGC operated 50 percent of the wells in which it participated versus 15 percent the previous year. Partner-operated activity declined from 24 of 28 wells drilled a year ago to 10 of 20 wells drilled in 1987.

Of the 20 wells drilled during the year, 15 were completed as oil wells, four were dry holes and one is currently suspended awaiting abandonment. MOGC was able to maintain a success ratio of 75 percent in its 1987 drilling program.

Since participating in its first well in late 1984, MOGC has acquired interests in 66 gross wells. Forty-seven wells are

Southwestern Manitoba
MOGC land position
☐ Producing oil fields

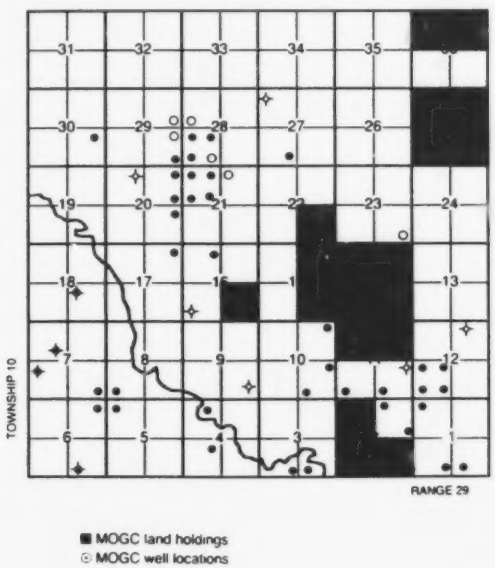
capable of producing oil, 13 are dry or have subsequently been abandoned, two wells are service wells and four are currently suspended. The Company's overall success ratio remains over 70 percent.

During the year the Company ran 85 kilometers of seismic in the Oak Lake, Cromer, Birtle and Elkhorn areas of the province. Information gained from seismic data shot during 1987 plus an aggressive drilling program will aid MOGC in its ongoing search for oil and gas in Manitoba during 1988.

After undertaking to substantially increase its acreage position in 1986, the Corporation selectively acquired interests in an additional 9,820 acres during 1987. This brings MOGC's land holdings to 47,207 gross acres (38,998 net) compared with 37,387 gross acres (32,898 net) in 1986, a 26 percent increase overall.

Increased drilling experience and knowledge, additional land holdings and valuable seismic information combine to place the Company in the ideal position of being able to evaluate its lands during 1988 and actively pursue development in the forthcoming years.

NORTH EBOR



Drilling continued in the North Ebor area during 1987. Three of four wells drilled were completed as oil wells and one was a dry hole.

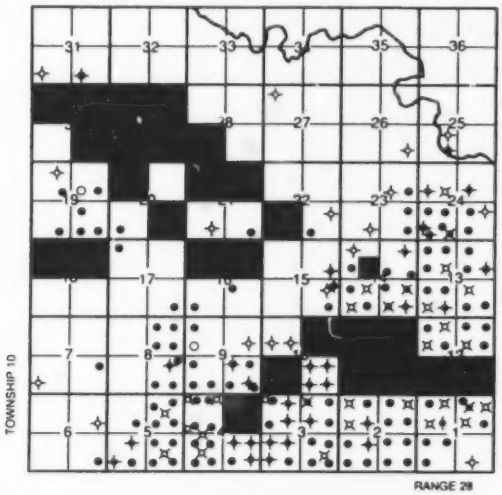
Two of the four wells were considered exploratory tests and the remaining wells were classified as development locations. One of the exploratory wells was dry.

MOGC's high working interest and multi-zone potential from the Lodgepole and Bakken formations make this an attractive area.

The Company holds an average 87 percent working interest in the North Ebor wells and has interests ranging from 25 to 100 percent in 2,200 gross (1,770 net) undeveloped acres within the area.

Further exploratory and development drilling is planned for the area during 1988.

NORTH DALY



■ MOGC land holdings
⊙ MOGC well locations
■ MOGC land holdings
— deep rights only

Twelve wells were drilled in 1987 in the North Daly area. Nine of the wells were successfully completed, one is awaiting completion and two were dry. Ten wells were classified as development locations and two were classified as exploratory locations. Of the ten development locations, nine are producing or will produce and one was dry. One of the two exploratory locations was dry. In addition, one of the development wells was drilled to test lower formations and later completed uphole in a Lodgepole zone.

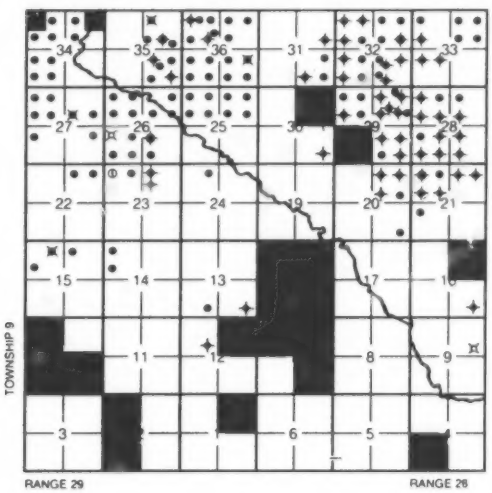
Production in this area is established from the Bakken and Lodgepole formations.

In addition to participating in drilling on farmout lands, MOGC successfully acquired crown leases covering 480 gross acres in 1987. Together with an out-of-province partner, MOGC drilled two test wells on these leases, both of which were completed as oil wells.

The Company holds an average 30 percent working interest in the North Daly wells and has 1,920 gross (719 net) undeveloped acres within the area.

MOGC will continue development drilling in the North Daly area in 1988.

WEST CROMER



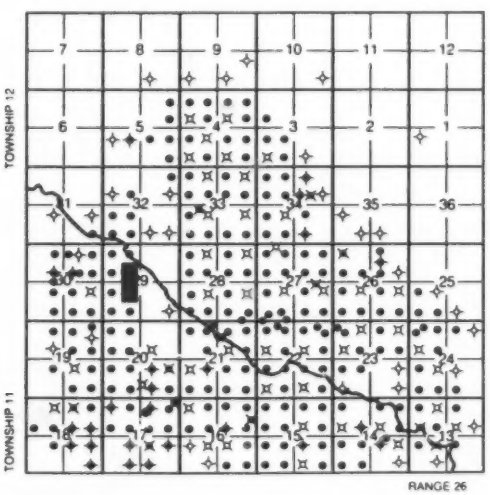
In 1987 the Company drilled and completed one successful exploratory well in this area.

Multi-zone potential is evident with production occurring from the Lodgepole Formation.

The Company holds a 100 percent working interest in this well and holds a 100 percent in 2,840 undeveloped acres within the area.

In addition, the Company ran seismic in this area in late 1987 with plans for further exploratory and development drilling in 1988.

NORTH VIRDEN



The Company continues to hold a 50 percent working interest in two oil wells which were drilled during 1985. In order to increase recoverable reserves, plans for the proposed North Virden Scallion Unit No. 2 waterflood scheme are proceeding with ICG Resources as designated Operator. It was expected that the Unit would be formed during 1987 but this has been delayed until 1988.

PRODUCTION AND RESERVES

The Company approximately doubled its production from 110 barrels per day in December, 1986 to 212 barrels per day in December, 1987. Most of MOGC's production is generated from the key areas previously highlighted.

A Corporate milestone was reached in 1987 when Company-operated production volumes exceeded partner-operated volumes.

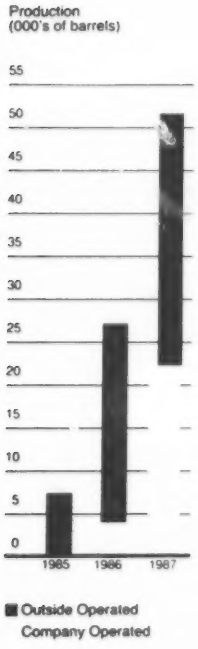
During 1987 the Company successfully completed and produced several wells from the Bakken formation. The Corporation also pioneered the co-mingling of two low-volume zones in Manitoba by combining marginal production from two separate zones into one profitable production stream.

The Corporation's 21.5 net oil wells produced a total of 212 barrels of oil per day on December 31, 1987, an average of 10 barrels per well. There are also four wells that are currently suspended and two wells that are classified as salt water disposal.

RESERVES

The Company's oil reserves and future cash flow from those reserves are reviewed annually by independent petroleum consultants.

The 1987 exploration and development program resulted in the addition of 289,700 barrels of reserves, an increase of 27 percent.



Proved Reserves Summary

	1987	1986	1985
Barrels			
Balance, January 1	**1,081,000**	375,600	—
New reserves added	**753,000**	896,000	383,100
Revisions	**(463,300)**	(163,500)	—
Reserves produced	**(51,700)**	(27,100)	(7,500)
Balance December 31	**1,319,000**	1,081,000	375,600

Notes

Proved reserves are the estimated quantities of crude oil which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years under existing economic and operating conditions.

The process of estimating reserves is complex, requiring professional judgements in the evaluation of available geological, engineering, economic and other data.

FINANCIAL REVIEW

Overview
1987 represents a year in which some notable Corporate gains were made. Production nearly doubled from 27,100 barrels a year ago to 51,700 barrels in 1987. Significantly, Company-operated wells accounted for 43 percent of total production compared with just 15 percent in 1986. The Company also added 289,700 barrels to its proved reserves base and, underlying improved performance for the industry as a whole, crude oil prices averaged $4.05 per barrel higher than the previous year.

Revenue
Operating revenues, net of royalties, increased 138 percent to $1,028,900 from $432,900 in 1986. This increase was achieved as a result of higher oil prices and production levels. Crude oil prices averaged $22.75 per barrel in 1987 compared to $18.70 the previous year, a 22 percent increase overall. Production levels rose to 51,700 barrels from 27,100 barrels a year ago.

Royalties declined slightly as a percentage of sales from 10.6 percent to 10.3 percent. These costs remained generally low and reflect incentives available from production on crown land.

Additional revenues of $160,500 were realized from the Company's ten percent interest in an oil pipeline located between Waskada and Cromer, Manitoba.

Expenses
Production and operating costs increased 70 percent to $433,900 due to higher production volumes. On a per-unit-basis, average operating costs were $7.78 per barrel of oil compared to an average of $8.00 in 1986. During the latter part of 1987 the Company undertook a deliberate program to reduce its operating costs, the results of which will continue to be reflected in the coming year.

Net general and administrative expense was $538,600, after recoveries and capitalized overhead, compared to $457,300 in 1986. This increase was a reflection of overall corporate growth plus the existence of a field office in Virden, Manitoba for the entire portion of the year.

Depletion and depreciation increased to $475,100 from $286,000 in 1986 reflecting increased production during the year. Expressed on a cost-per-barrel basis, depletion and depreciation on petroleum equipment and facilities amounted to $6.93 per barrel of oil in 1987 versus $6.00 per barrel in 1986.

Capital Spending
Capital expenditures during 1987 amounted to $3,370,400 for a total investment in property and equipment of $10,456,700. Approximately 80 percent of the current year's expenditures were committed to drilling and production development, indicating a continued shift in emphasis from land acquisition to seismic and drilling activities as the Company continues to mature.

Liquidity
The Company has maintained a strong working capital position during the year as a result of its equity financing arrangements described in the notes to the financial statements. During 1987 an additional $5,000,000 of shares were subscribed. As a result, working capital increased to $4,338,000 from $2,478,000 in 1986. Net cash flow from operations in 1987 was $230,600.

AUDITOR'S REPORT

To the Shareholders of The Manitoba Oil and Gas Corporation

We have examined the balance sheet of The Manitoba Oil and Gas Corporation as at December 31, 1987 and the statements of operations and deficit and of changes in cash resources for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

March 10, 1988

Deloitte Haskins & Sells

[redacted]

Chartered Accountants

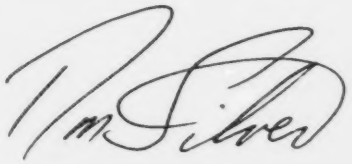
BALANCE SHEET

As at December 31,	1987	1986
Assets		
Cash	$ 167,930	$ 75,049
Funds held in trust (note 4)	3,700,000	2,600,000
Accounts receivable (note 7)	1,259,826	113,373
Drilling advances	26,025	115,963
Inventories	56,683	29,748
Deposits and prepaid expenses	52,224	23,890
	$5,262,688	$2,958,023
Property and equipment less accumulated depletion, depreciation and amortization (note 3)	$9,416,642	$6,521,365
	$14,679,330	$9,479,388
Liabilities		
Accounts payable	$ 924,233	$ 479,755
Equity, Province of Manitoba		
Share capital (note 4)	$15,000,000	$10,000,000
Deficit	1,244,903	1,000,367
	$13,755,097	$ 8,999,633
	$14,679,330	$ 9,479,388

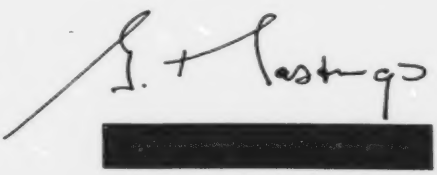
The accompanying notes are an integral part of this balance sheet.

Approved on Behalf of the Board

Director



Director



STATEMENT OF OPERATIONS AND DEFICIT

For the Years Ended December 31,	1987	1986
Revenue		
Petroleum sales	**$1,147,480**	$ 484,134
Less: Royalties	**118,532**	51,206
	$1,028,948	$ 432,928
Pipeline fees	**160,486**	169,737
Interest and other income	**13,614**	25,916
	$1,203,048	$ 628,581
Expenses		
Production and operating	**$ 433,856**	$ 255,816
General and administrative	**538,601**	457,262
Depletion, depreciation and amortization	**475,127**	285,958
	$1,447,584	$ 999,036
Net loss for the year	**$ 244,536**	$ 370,455
Deficit, beginning of year	**$1,000,367**	$ 629,912
Deficit, end of year	**$1,244,903**	$ 1,000,367

The accompanying notes are an integral part of this statement.

STATEMENT OF CHANGES IN CASH RESOURCES

For the Years Ended December 31,	1987	1986
Operating Activities		
Loss from operations	$(244,536)	$(370,455)
Depletion, depreciation and amortization	475,127	285,958
	$ 230,591	$(84,497)
Net change in non cash working capital related to operations	(115,504)	13,650
	$ 115,087	$(70,847)
Financing Activities		
Issuance of share capital	$ 5,000,000	$ 5,000,000
Investing Activities		
Expenditures on property and equipment	$(3,370,404)	$(3,662,655)
Net change in non cash working capital related to capital expenditures	337,761	169,178
	$(3,032,643)	$(3,493,477)
Other		
Payments on behalf of the Province of Manitoba (note 7)	$(889,563)	—
Net Increase in Cash	$ 1,192,881	$ 1,435,676
Cash, Beginning of Year	$ 2,675,049	$ 1,239,373
Cash, End of Year	$ 3,867,930	$ 2,675,049

"Cash" comprises cash and funds held in trust

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1987

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements have been prepared by management in accordance with generally accepted accounting principles. The Corporation's more significant accounting policies are summarized below.

Joint Ventures

Substantially all of the Corporation's exploration activities are conducted jointly with others. These financial statements reflect only the Corporation's proportionate interest in such activities.

Petroleum and Natural Gas Properties

The Corporation follows the full cost method of accounting for oil and gas operations wherein all costs related to the exploration for and development of oil and gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on undeveloped properties, costs of drilling both productive and nonproductive wells and all technical and administrative overhead directly associated with exploration and development activities.

Proceeds from the disposition of oil and gas assets are credited against accumulated costs unless such a disposition would significantly alter the relationship between capitalized costs and proved reserves. Gains and losses on other property and equipment dispositions are recognized in the statement of operations.

Ceiling Test

The Corporation places a limit on the aggregate costs that can be capitalized as Petroleum and Natural Gas expenditures (the Ceiling Test) which conforms with the full cost accounting guideline issued by the Canadian Institute of Chartered Accountants. This "ceiling" is equal to the future net revenues from proved reserves, net of estimated future general and administrative costs, plus the lower of cost and fair market value of non producing properties.

In determining future revenues, the Company applied a price of $22.75 per barrel (1986 — $18.70) based on average prices received during the year. No adjustment would be required if the year end price of $20.80 per barrel (1986 — $19.55) had been applied.

Depletion, Depreciation and Amortization

Depletion of oil and gas properties and depreciation of production equipment and facilities are calculated using the unit-of-production method based on estimated proved reserves of oil and gas. Costs of acquiring and evaluating unproved properties are excluded from capitalized costs to be depleted until it is determined whether or not proved reserves are attributed to the properties or impairment in value has occurred.

Cumulative expenditures excluded from costs subject to depletion and depreciation were $1,972,600 (1986 — $1,742,400).

Depreciation on other equipment is calculated at rates ranging from twenty to twenty-five percent. Leasehold improvements are amortized over the remaining term of the lease plus one renewal period.

Capitalized Costs
In applying the full cost method of accounting the Company capitalized general and administrative costs directly associated with exploration and development totalling $267,900 (1986 — $280,300).

2. STATUS OF THE CORPORATION

The Manitoba Oil and Gas Corporation was established as a Crown Corporation under The Manitoba Oil and Gas Corporation Act, Bill 4, in 1983. Under the provisions of its Act, the Corporation conducts activities to promote exploration for and development of oil and gas as a direct participant in the industry.

3. PROPERTY AND EQUIPMENT

	1987			1986
	Cost	**Accumulated Depreciation Depletion & Amortization**	**Net Book Value**	Net Book Value
Petroleum and natural gas properties including exploration & development thereon	**$ 8,335,286**	**$ 607,716**	**$7,727,570**	$5,148,749
Pipeline investment	**544,132**	**174,780**	**369,352**	410,009
Production equipment	**1,215,497**	**111,200**	**1,104,297**	720,646
Other	**361,805**	**146,382**	**215,423**	241,961
	$10,456,720	**$1,040,078**	**$9,416,642**	$6,521,365

4. SHARE CAPITAL

As a Crown corporation, the Corporation issues share certificates to the Minister of Finance in exchange for equity financing. Proceeds available to the Corporation in respect of shares issued are held in trust by the Minister to be advanced as funds are required to finance operations.

Undisbursed funds held in trust are non interest-bearing to the Corporation.

Authorized
The Corporation is authorized to issue 200,000 shares for maximum consideration of $20,000,000.

Issued	1987		1986	
	Shares	Amount	Shares	Amount
Beginning of year	100,000	$10,000,000	50,000	$ 5,000,000
Issued	50,000	5,000,000	50,000	5,000,000
End of year	150,000	$15,000,000	100,000	$10,000,000
Proceeds advanced		11,300,000		7,400,000
Funds held in Trust		$ 3,700,000		$ 2,600,000

5. EMPLOYEE PENSION PLAN

Under the terms of the Company's pension plan, employee contributions are matched by the Corporation and these amounts are contributed to a money-purchase pension plan. As a result, there are no unfunded pension plan liabilities and no outstanding corporate obligations.

6. COMMITMENTS

The Corporation has lease commitments of $87,500 per year for the next two years.

7. RELATED PARTY TRANSACTIONS

These financial statements include routine operating transactions conducted at prevailing market prices with various Province of Manitoba departments, agencies and corporations.

Certain information as to related parties is not available by virtue of the fact that the Company conducts a substantial portion of its activities through joint ventures which are not required to report routine operating transactions with MOGC-related parties.

During 1987, the Government of Manitoba undertook a number of initiatives designed to reduce the cost of natural gas consumed by Manitobans and, related to these efforts, incurred expenses which were funded by MOGC. Consequently, included in the accounts at December 31, 1987 is an amount receivable of $889,563 representing disbursements related to natural gas activities which remain to be reimbursed by the Province.

CORPORATE INFORMATION

DIRECTORS

Robert M. Silver, *Chairman*
President
Manitoba Public Insurance Corporation

Alan D. Bourgeois
Lawyer

Garry R.S. Hastings, *Secretary Treasurer*
Executive Officer
Manitoba Energy Authority

Andrew Janisch
President
Quintana Exploration Canada Ltd.
Calgary, Alta.

Dr. John Ryan
Professor of Geography
University of Winnipeg

MANAGEMENT

John R. Sadler
President

Randy R. Irvine
Resource Development Manager

Warren H. Johnston
Operations Manager

Marc R. Junghans
Chief Geologist

Cindy V. Marchant
Landman

Ken J. Neufeld
Controller

Barbara A. Poruchny
Administrative Officer

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AUDITORS

Deloitte, Haskins & Sells
Winnipeg, Manitoba

RESERVES AUDITORS

Esau, Finn and Associates Ltd.
Vancouver, B.C.